APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

OCTOBER TERM, 1970

No. 30116 & 30117

D.C. Docket No. CA 65-61 & CA 65-333

VULCAN MATERIAL COMPANY, *Plaintiff-Appellant,*

v.

UNITED STATES OF AMERICA, *Defendant-Appellee.*

Appeals from the United States District Court for the Northern District of Alabama

Before BELL, AINSWORTH and ALDISERT,* Circuit Judges.

Judgment

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Alabama, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, affirmed;

It is further ordered that plaintiff-appellant pay to defendant-appellee, the costs on appeal to be taxed by the Clerk of this Court.

May 28, 1971

Issued As Mandate: July 6, 1971.

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* Of the Third Circuit, sitting by designation.

[Filed June 25, 1971]

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

OCTOBER TERM, 1970

No. 30116 & 30117

VULCAN MATERIALS COMPANY, *Plaintiff-Appellant,*

v.

UNITED STATES OF AMERICA, *Defendant-Appellee.*

Appeals from the United States District Court for the Northern District of Alabama

(June 25, 1971)

Before BELL, AINSWORTH and ALDISERT,* Circuit Judges.

On Petition for Rehearing

PER CURIAM:

IT IS ORDERED that the petition for rehearing filed in the above entitled and numbered cause be and the same is hereby denied.

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* Of the Third Circuit, sitting by designation.

IN THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

Nos. 30116 & 30117

VULCAN MATERIALS COMPANY, *Plaintiff-Appellant,*

v.

UNITED STATES OF AMERICA, *Defendant-Appellee.*

Appeals from the United States District Court for the Northern District of Alabama

(May 28, 1971)

Before BELL, AINSWORTH and ALDISERT,*
Circuit Judges.

ALDISERT, Circuit Judge: Two principal issues are presented by these appeals from the district court's denial of federal income tax refunds: (I) whether organization or reorganization expenses incurred by appellant's predecessors, and concededly capital in nature and not deductible when incurred, became deductible upon the occurrence of statutory mergers carried out pursuant to 26 U.S.C. § 368 (a)(1)(A); (II) whether appellant met its burden of overcoming the Commissioner's determination that one of its predecessors, Follansbee Steel Corporation, had acquired two other corporations for the principal purpose of tax avoidance. If appellant did not satisfy this burden, it is conceded that net operating loss carryovers were properly disallowed under 26 U.S.C. § 269(a)(2).

A stipulation of facts with accompanying documentary exhibits constituted the sole evidence at trial. No oral testimony was offered. The salient facts are summarized in the opinion of the district court, 308 F. Supp. 53, 54-55 (N.D. Ala. 1969):

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* Of the Third Circuit, sitting by designation.

On December 23, 1954, Consumers Company (Consumers) and Frontier Chemical Company (Frontier), both Delaware corporations, were merged into a third Delaware corporation theretofore named Follansbee Steel Corporation (Follansbee). Prior to the aforementioned merger, Follansbee disposed of all of its operating assets. Upon merger, the corporation owned approximately nine million dollars in liquid assets and had an approximate six million dollar net operating loss. In the merger proceedings, the name of the surviving corporation was changed from Follansbee Steel Corporation to Union Chemical and Material Corporation (Union Chemical). On December 31, 1957, Union Chemical was merged into the plaintiff. Each of the aforementioned mergers constituted reorganizations within the meaning of Section 368(a)(1)(A) of the Internal Revenue Code of 1954. . . .

In 1934, the predecessor of Consumers filed a petition in the United States District Court for the Northern District of Illinois for a reorganization under Section 77B of the Bankruptcy Act. During the period 1933 through 1937, various expenditures were incurred with respect to the reorganization and to the organization of the former corporation into Consumers. Likewise, Follansbee's predecessor filed a petition in bankruptcy in 1934 and in 1940 was reorganized into Follansbee Steel Corporation. In 1946, a further corporation merged with Follansbee and as a result of the reorganization and merger, expenses were alleged to have been incurred. Each of the aforementioned expenditures is conceded to be capital in nature and thus not deductible when paid or incurred.

On its 1957 corporate income tax return, Union Chemical deducted all of the aforementioned expenses. A subsequent audit resulted in the disallowance of these deductions, followed by a deficiency assessment

totaling $369,453.93 which was paid. A claim for refund of this amount was filed and thereafter rejected on the theory that the aforementioned expenditures were capital in nature and not deductible upon merger.

The Internal Revenue Service further refused to make a refund based on a depletion allowance on the ground that plaintiff had improperly carried over Follansbee's premerger net operating losses in contravention of Sec. 269 of the 1954 Code. Although the deficiency which resulted from the carry-forward was not assessable due to the bar of the statute of limitations, it was nevertheless of sufficient size to offset any recovery to which the plaintiff might otherwise have been entitled. On March 24, 1965, plaintiff's claim for refund was formally rejected.

. . .

Prior to December 23, 1954, the date on which Consumers and Frontier merged into Follansbee, the latter corporation disposed of all of its machinery, tools, inventory, etc., which it used in its steel operation; hence, the corporation was but a mere shell. However, on the date of merger its sole possessions consisted of approximately nine million dollars in liquid assets and approximately a six million dollar net operating loss which it could not utilize due to the abatement of its operations. The companies which merged into Follansbee were engaged in the stone and chemical business. Following the merger, the new entity continued to operate profitably. In each of the years 1955, 1956 and 1957, portions of the pre-merger net operating loss suffered by Follansbee were used to offset the profits of the Consumers and Frontier enterprises.

I.

Reorganization Expenses

It is well established that recapitalization or reorganization expenditures of a corporation are not ordinary and necessary business expenses but rather capital expenditures which are not deductible when incurred. *General Bancshares Corp.* v. *Commissioner,* 326 F.2d 712 (8 Cir.), *cert. denied,* 379 U.S. 832 (1964); *Bush Terminal Bldgs. Co.* v. *Commissioner,* 204 F.2d 575 (2 Cir. 1953); *Missouri-Kansas Pipe Line Co.* v. *Commissioner,* 148 F.2d 460 (3 Cir. 1945). In *Godfrey* v. *Commissioner,* 355 F.2d 82, 85 (6 Cir. 1964), the court stated:

> An expenditure is of a capital nature "where it results in the taxpayer's acquisition or retention of a capital asset, or in the improvement or development of a capital asset in such a way that the benefit of the expenditure is enjoyed over a comparatively lengthy period of business operation." Louisiana Land & Exploration Co. 1. Commissioner, 7 T.C. 507, aff'd. 161 F.2d 842, C.A. 5 [(1947)]. . . .

While appellant concedes that the capital expenditures were not deductible when paid or incurred, the government acknowledges that capital expenditures of the nature here involved may be deducted upon the dissolution and liquidation of a corporation. *Bryant Heater Co.* v. *Commissioner,* 231 F.2d 938 (6 Cir. 1956); *Commissioner* v. *Wayne Coal Mining Co.,* 209 F.2d 152 (3 Cir. 1954); *Shellabarger Grain Products Co.* v. *Commissioner,* 146 F.2d 177 (7 Cir. 1944; *Koppers Co.* v. *United States,* 278 F.2d 946 (Ct. Cl. 1960); *Pacific Coast Biscuit Co.* v. *Commissioner,* 32 B.T.A. 39 (1935); *Malta Temple Assn.* v. *Commissioner,* 16 B.T.A. 409 (1929).

The issue here is whether the organization or reorganization expenses of appellant's predecessors may now be claimed as deductions, as urged by appellant, or whether the distinctions between dissolution and merger will preclude such deductions in a merger situation.

A statutory merger[1] effects a combination of two or more corporations in accordance with the detailed procedures established by the corporation laws of a state, with one of the corporations continuing as the same legal entity it was before the transaction. Stated differently, a merger is

> the absorption of one corporation by another, which retains its name and corporate entity with the added capital, franchises and powers of the merged corporation. It is the uniting of two or more corporations by the transfer of property to one of them, which continues in existence, the others being merged therein.

15 FLETCHER, CYCLOPEDIA OF CORPORATIONS § 7041. See *Argenbright* v. *Phoenix Finance Co.*, 21 Del. Ch. 288, 187 A. 124 (1936); *Fidanque* v. *American Maracaibo Co.*, 92 A.2d 311 (Del. Ch. 1952)). Thus, the distinguishing characteristics of a merger are (1) an assumption by the surviving corporation "of all the rights and liabilities of the disappearing entitles," 8 CAVITCH, BUSINESS ORGANIZATIONS § 167.07[2], and (2) the cessation of the "separate existence of all the constituent corporations . . . except the one into which the other or others of such constituent corporations have been merged." 8 Del. Code Anno. § 259(a).

A corporate dissolution, on the other hand, represents the termination of the corporation's existence as a legal person. Once corporate existence ends, so do the privileges, powers, rights and duties which arose from corporate existence, except for specific purposes recognized by operation of law. 8 CAVITCH, *supra*, § 185.02.

> The term "dissolution" as applied to a corporation, signifies the extinguishment of its franchise to be a

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[1] See 8 Del. Code Anno. § 251 *et seq.* and 14 N.J. Stat. Anno. 14:21-1 *et seq.* for the statutory provisions of the states in which the corporations were organized.

> corporation and the termination of its corporate existence. It has been described as that condition of law and fact which ends the capacity of the body corporate to act as such and necessitates a liquidation and extinguishment of all legal relations existing in respect of the corporate enterprise. It denotes the complete destruction of the corporation, and, within contemplation of law, is equivalent to its death, being sometimes likened to the death of a natural person.

16A FLETCHER, *supra*, § 7866.[2]

Thus, although in both a statutory merger and a dissolution the merged or dissolved corporate entity ceases to exist, fundamental distinctions inhere in the two processes. In a dissolution, the privileges, powers, rights and duties of the corporation come to an end and suffer a corporate death.[3] In a merger, these attributes of corporate life are transferred to the surviving corporation and are there continued and preserved. It has been said that "all 'rights, powers, liabilities and assets' [survive] except the 'indicia and attributes of a corporate body distinct from that

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[2] Dissolution and liquidation refer to entirely separate concepts: a liquidation has no direct effect upon the existence or non-existence of the corporate entity; it concerns the settling of the corporate affairs, *i.e.*, gathering assets, accounting with creditors and debtors, and apportioning the profit or loss to its stockholders. Farmers' State Bank & Trust Co. v. Brady, 137 Tex. 39, 152 S.W.2d 729 (1941); *In re Burger's Estate,* 276 Mich. 485, 267 N.W. 887 (1936); Browne v. Hammett, 133 So.C. 446, 131 S.E. 612 (1926); Gibson v. American Ry. Express Co., 195 Iowa 1126, 193 N.W. 274 (1923).

[3] "From the time of that entry [order of dissolution] the corporation has been dead, all its agencies ended, its employees, including attorneys, discharged: and is put, without exception or notice of appeal, beyond all future corporate activity." *State ex rel. Attorney General* v. *Fidelity Loan & Trust Co.*, 113 Iowa 439, 440, 85 N.W. 638-39 (1901).

into which it is merged.' " *Citizens Trust Co.* v. *Commissioner,* 20 B.T.A. 392, 393 (1930).

Recognizing these distinctions, we accept the government's contention that the provision for deduction of capital expenditures upon dissolution of a corporation is not applicable when the corporation becomes a constituent of a surviving corporation in a merger. The organization and reorganization expenses of the constituent corporations in the case at bar were clearly capital in nature. These assets were not lost but were continued beyond the corporate existence of the constituent corporations and persisted as capital assets of the surviving corporation. So construed, the expenses were not deductible.[4]

II.

Operating Loss Carryover

Appeal No. 30,177[5] requires us to decide whether the net operating loss incurred by Follansbee Steel Corporation in its taxable year 1954, which was not absorbed by its

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[4] Another point was raised for our consideration in the appeal at 30,116: whether payment by Consumers Company, a predecessor corporation, to the state of Illinois, allegedly for the privilege of doing business, qualifies as a deduction. Upon proof that payment was made to the State of Illinois for that purpose and that such right was duplicative or no longer necessary, it could be a proper subject for consideration. We are not persuaded, however, that appellant met the appropriate burden of proof. The stipulation, 8 (p) merely states:

> Secretary of State of Illinois—$3,209.24. The amount listed was paid to the Secretary of State of Illinois for various services including fees for ministerial and recording services required under applicable state laws of Illinois.

[5] The parties stipulated that if it is concluded that the net operating losses are not allowable as deductions under section 172 by reason of section 269, the taxpayer will not be entitled to any recovery in Appeal No. 30,117 because taxpayer's indebtedness to the United States exceeds the amount claimed in these actions.

taxable income or that of its successor Union Chemical and Material Corporation in taxable years prior and subsequent thereto, was allowable to Union Chemical as a deduction for its taxable year 1957 pursuant to 26 U.S.C. § 172. The Commissioner disallowed the deduction by reason of section 269(a)(2),[6] finding that the principal purpose of the merger of Follansbee (the loss corporation) and Consumer and Frontier (profit corporations), was to utilize the net operating loss of Follansbee to offset future income of the surviving corporation.

Follansbee discontinued its steel operations and sold its assets prior to the merger in 1954. Thus, by the time of the merger it had become a non-operating corporation with liquid assets of $9,000,000.00, and a net operating loss of $6,000,000.00 resulting from the sale of assets. Follans-

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[6] Internal Revenue Code of 1954, 26 U.S.C.:

§ 269. *Acquisitions made to evade or avoid income tax.*
(a) In general.—If—

(1) any person or persons acquire, or acquired on or after October 8, 1940, directly or indirectly, control of a corporation, or

(2) any corporation acquires, or acquired on or after October 8, 1940, directly or indirectly, property of another corporation, not controlled, directly or indirectly, immediately before such acquisition, by such acquiring corporation or its stockholders, the basis of which property, in the hands of the acquiring corporation, is determined by reference to the basis in the hands of the transferor corporation, and the principal purpose for which such acquisition was made is evasion or avoidance of Federal income tax by securing the benefit of a deduction, credit, or other allowance which such person or corporation would not otherwise enjoy, then [such deduction, credit, or other allowance be disallowed]. For purposes of paragraphs (1) and (2), control means the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote or at least 50 percent of the total value of shares of all classes of stock of the corporation.

bee successfully claimed the carryback against income earned and reported in taxable years prior to 1954 as a deduction under Section 172. What the Commissioner challenged was the attempt by Union Chemical, the successor corporation after the merger, to take advantage of the loss carryback of Follansbee.

Immediately prior to the merger, Frontier was actively operating in the field of chemicals, and Consumer in building materials, coal and ice. Following the merger, stockholders of the loss corporation, Follansbee, obtained 57% controlling interest in the surviving corporation, which continued the former operations of Frontier and Consumer with its corporate name changed to Union Chemical.

Although the acquisition of a controlling stock interest in a corporation may serve multiple purposes, if the primary or single most important purpose of the acquisition is tax avoidance or evasion, tax benefits are barred.[7]

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[7] Section 269 was "designed to put an end promptly to any market for, or dealings in, interests in corporations or property which have as their objective the reduction through artifice of the income or excess profits tax liability." H. Rep. No. 871, 78th Cong., 1st Sess., 49 (1944 Cum. Bull. 901, 938). The Senate Report to the Revenue Act of 1943 makes it clear that the proscribed purpose exists "if the evasion or avoidance purpose outranks or exceeds in importance, any other *one* purpose." H. Rep. No. 627, 78th Cong., 1st Sess., 59 (1944 Cum. Bull. 973, 1017).

Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.) provide:

> § 1.269-3 *Instances in which section 269(a) disallows a deduction, credit, or other allowance.*
>
> (a) *Instances of disallowance.* Section 269 specifies two instances in which a deduction, credit or other allowance is to be disallowed. These instances [are] described in paragraphs (1) and (2) of section 269(a). . . .
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> . . .

In either instance the principal purpose for which the acquisition was made must have been the evasion or avoidance of Federal in-

In *Southland Corp.* v. *Campbell,* 358 F.2d 333, 336 (5 Cir. 1966), this court emphasized that section 269 "is applicable only in certain carefully circumscribed situations—it may be invoked only where there has been an acquisition of *control,* the *principal purpose* of which is evasion or avoidance of taxes." (Emphasis by the court).[8] The statute defines "control" as the ownership of stock possessing at least 50 percent of the total combined voting power of all

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come tax by securing the benefit of a deduction, credit, or other allowance which such person or persons, or corporation, would not otherwise enjoy. If this requirement is satisfied, it is immaterial by what method or by what conjunction of events the benefit was sought. Thus, an acquiring person or corporation can secure the benefit of a deduction, credit, or other allowance within the meaning of section 269 even though it is the acquired corporation that is entitled to such deduction, credit, or other allowance in the determination of its tax. If the purpose to evade or avoid Federal income tax exceeds in importance any other purpose, it is the principal purpose. This does not mean that only those acquisitions fall within the provisions of section 269 which would not have been made if the evasion or avoidance purpose was not present. The determination of the purpose for which an acquisition was made requires a scrutiny of the entire circumstances in which the transaction or course of conduct occurred, in connection with the tax result claimed to arise therefrom. For the presumption of a principal purpose of tax evasion or avoidance, see section 269(c) and § 1.269-5.

[8] In *Southland* the loss corporation was Carribean, a shipping business in which Murchison Brothers had a 50 percent ownership. The profitable corporation was Old Cabell's, engaged in the dining and grocery business. Murchison stockholders, the majority stockholders in Old Cabell's, gave to Caribbean their stockholdings in Old Cabell's, and later donated back to Caribbean substantial shares of Caribbean stock. Subsequently the two corporations merged, with Caribbean being the surviving corporation. The court held that the acquisition portion of 269(a) was not met because "immediately before Caribbean acquired control of it, Old Cabell's was controlled by the stockholders of Caribbean, and, therefore, under the express terms of the statute it is not applicable." 358 F.2d at 337.

classes of stock entitled to vote, or at least 50 percent of the total value of shares of all classes of stock. *See* 2 RABKIN & JOHNSON FEDERAL INCOME, GIFT & ESTATE TAXATION, § 11.05.

Thus, we are concerned with two lines of inquiry: (a) whether there has been an acquisition of control[9] as contemplated by section 269, and, if so, (b) whether the principal purpose of the merger was to evade or avoid taxes.

It is important to recognize what is not before us. We do not have a single corporation, which, with no change in stock ownership, discontinued a losing business and entered a totally different venture which proved to be profitable; nor do we have a single corporation which experienced

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[9] The government urges that this case may turn on the test set forth in Revenue Ruling 63-40: Where there is no change in stock ownership either before the discontinuance of its former business activity or after the commencement of its new business activity, the net operating loss deduction is allowable. But where there is "more than a minor change in stock ownership of a loss corporation which acquires a new business enterprise, the Service may continue to contest the deductibility of the carry-over of the corporation's prior losses against income of the new business enterprise." We consider this a simplistic approach. The question is not the *amount* of stock ownership change, but the *effect* of the change upon control.

Addressing itself to the question of control, Technical Information Release No. 773 of the IRS dated October 13, 1965, declared: "where there has been both a 50 per cent or more shift in the benefits of a loss carryover (whether direct or indirect and including transactions having the effect of shifting the benefits of the loss by shifting assets, stock, profit interests or other valuable rights) and a change in business as defined in section 382(a) and the regulations thereunder," the doctrine of *Libson Shops Inc.* v. *Koehler*, 353 U.S. 382 (1957) will be applied: "a surviving corporation in a merger may not carry over and deduct pre-merger net operating losses of one business against post-merger income of another which was operative and taxed separately before the merger." Rev. Ruling 58-603, TIR-89, August 25, 1958.

a substantial change in ownership in the same taxable year in which the "corporation [had] not continued a trade or business substantially the same as that conducted before the change in the percentage ownership" of the stock. 26 U.S.C. § 382(a); nor did the situation here involve a statutory merger of several corporations, each of which conducted substantially the same business prior to the merger, with no basic post-merger change of stock ownership, as in *Libson Shops Inc.* v. *Koehler,* 353 U.S. 382 (1957); nor did a corporation which, after reorganization in which there had not been a 50 percent change in the beneficial ownership of the loss, engage in substantially the same business, as in *United States* v. *Jackson Automobile, Inc.,* (sic) 371 F.2d 808 (5 Cir. 1967); nor was there a merger of two corporations, each of which was controlled by the same stockholders prior to the merger as in *Southland Corp.* v. *Campbell, supra;* nor was this a statutory merger in which the surviving corporation conducted a business substantially different from that previously operated by the loss corporation but with only a minor change in the beneficial ownership of the loss, Rev. Rul. 63-40.

What we do have is: (1) a substantial change in the beneficial ownership of the loss, but not one which exceeds 50 percent, for the original stockholders of Follansbee, who owned 100 percent of the loss corporation stock, became owners of 57 percent of the surviving corporation of the merger; (2) a substantial change in the beneficial ownership of a profitable corporation—these same stockholders who had no ownership before the merger became owners of 57 percent thereafter; (3) a subsequent operation of a business substantially different from that previously conducted by the loss corporation.

Because the Follansbee stockholders who owned 100 percent of the pre-merger loss corporation ultimately owned over 50 percent of the acquiring corporation, and because there was no surrender of 50 percent of the beneficial

ownership of the loss, it is suggested that a provision of the Commissioner's Technical Information Release No. 773, *supra,* note 9, if literally applied, would authorize the deduction:

> The Service will not rely on *Libson Shops* under the 1954 Code in any loss carryover case where there has been less than a 50 percent change in the beneficial ownership of the loss or where there has been no change in business as defined in section 382(a) and the regulations thereunder. However, the Service will continue to rely on sections 269 and 482, where appropriate, in dealing with the carryover of losses. Revenue Ruling 63-40, C. B. 1963-1, 46 will be modified to the extent inconsistent herewith.

We do not quarrel with this statement as far as it goes. But the mischief in relying solely upon IRS technical releases and revenue rulings is that, for the most part, they speak to the limited fact situations before the Service at that moment. They do not purport to be comprehensive statements of substantive law. From this terse technical information release we cannot conclude that it is only a change in the beneficial ownership of the *loss* which will determine the allowance *vel non* of a net operating loss carryover.

Indeed, this court has deemed it settled that section 269 "is applicable when a 'loss' corporation acquires control of a 'profitable' corporation since the acquiring corporation thereby secures the *benefit* of a loss it would not have otherwise enjoyed. *F. C. Publication Liquidating Corp.* v. *Commissioner,* 304 F.2d 779, 781 (2 Cir. 1962)." *Southland Corp.* v. *Campbell, supra,* 358 F.2d at 336. In *F. C. Publication Liquidating Corp., supra,* the court denied a loss carryover. The loss corporation acquired a profitable corporation, giving the shareholder majority interest in the surviving corporation. There, as here, the business of the loss corporation was not continued; the surviving cor-

poration carried on the business previously conducted by the profitable corporation. Thus, these cases adhere to the principle enunciated in *Urban Redevelopment Corp.* v. *Commissioner*, 294 F.2d 328, 332 (4 Cir. 1961):

> It is now well established that the deduction should be disallowed when . . . it is claimed by either the acquired corporation or by the person who acquired control of the corporation and who will get the benefit of the deduction, albeit, indirectly.

In this case there was a shift of 57 percent of the ownership of a profitable corporation. Therefore, considering solely the question of "control," we are persuaded that there was an acquisition of the control, under section 269, of profitable corporations which gave the acquiring corporation "the benefit of a loss it would not have otherwise enjoyed." *F. C. Publication Liquidating Corp.* v. *Commissioner, supra.*

Paramount in our approach to the troublesome question of the merger's primary purpose is a recognition that the 26 U.S.C. § 269 does not foreclose the right of an acquiring corporation to take advantage of a past operating loss. Congress did not close the door to a proper and legitimate use of the net operating loss deduction by a successor corporation to a statutory merger. Moreover, even the change in control of either the beneficial ownership of the loss or profitable constituent corporations will not preclude the proper utilization of the operating loss carryover deduction. Congress sought to deny tax benefits only to those corporate acquisitions in which "the primary purpose . . . is evasion or avoidance of Federal income taxes."

Thus, if Follansbee's acquisition of the chemical and building materials companies was motivated by legitimate business reasons, that tax considerations played a role, even an important role, would not defeat the right to tax benefits so long as the tax considerations did not constitute

the "principal purpose" of the merger. Only "if the purpose to evade or avoid Federal income tax exceeds in importance any other purpose, [is it] the principal purpose." Treasury Reg. 41.269-3(a)(2).

There are several significant factors present in the events which gave rise to this appeal. The net operating loss itself is not questioned. It resulted from a sale of Follansbee assets in 1954, which took place prior to the December 23, 1954 merger. As noted, the Commissioner did not question the right of *Follansbee* to use this loss to offset earned income in years prior to 1954. It was only when *Union Chemical,* the successor corporation to the three-company merger, attempted to stand in the shoes of Follansbee, after the merger, and apply this loss to offset post-merger earned income that the Commissioner denied the deduction and made the determination of tax liability.

The taxpayer made the payment under protest, and sued for a refund. In such a proceeding, which is in the nature of a common law action for money had and received, the burden is on the taxpayer to prove that the Commissioner's determination of the tax was erroneous. *Lewis* v. *Reynolds,* 284 U.S. 281, 283 (1932). Moreover, in *Bobsee Corp.* v. *United States,* 411 F.2d 231, 238 (5 Cir. 1969) (footnote omitted), this court said:

> The burden of proving that tax avoidance was not the principal purpose is on the taxpayer. Theoretically the question of purpose is purely subjective; pragmatically, however, the trier of fact can only determine purpose from objective facts. Thus, unless the taxpayer can muster facts sufficiently plausible to convince the trier of the purity of his motives, the IRS will prevail.

As indicated above, there was no oral testimony adduced at trial. Pertinent facts to this issue were presented in paragraphs 31-34 of the written stipulation No explicit

statement for the purpose of the merger may be gleaned from paragraphs 31 and 32. Paragraph 33 delineated what financial equities were brought to and received by the merged group, and this was expressed only in statements of fair market value and book value. In addition, a reference was made to Follansbee's proxy statement and to a listing of shares. Paragraph 34 described the net operating loss carryover.

There is nothing explicit in the stipulation which describes the purpose of the merger. Therefore, we must look for illumination to Exhibit "C" which is "K. Summary" of the Proxy Statement issued by Follansbee to its shareholders prior to the meeting which approved the proposed merger. From the meager information therein presented, it becomes apparent that Follansbee had converted its assets to cash at some point before the stockholders' meeting.[10] We are not old, nor does the record disclose, the precise date of the sale of assets, or whether the sale was a Follansbee decision separate and apart from the proposed merger with Frontier and Consumer and independent of a proposed merger with any other companies. We are not told whether there was any contemplation of liquidation at the time of the sale of assets.

The proxy statement does disclose, however, the reason for the sale of assets—Follansbee's "relatively insecure position in the steel industry."[11] From the standpoint

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[10] Paragraph 33 indicates that as of September 9, 1954, Follansbee has already a liquid position showing cash of $9,286,620. Obviously the sale of assets took place before this date.

[11] "In considering the reason for the sale of Follansbee assets. Follansbee's relatively insecure position in the steel industry was discussed. Mention was also made of the present outlook of the industry generally. The most widely accepted index to conditions in the steel industry is the rate of operations as compared to capacity. Each month since January, 1953, the industry-wide rate of operations, has shown, except for minor and relatively insignificant recoveries, a steady decline. . . ."

of the taxpayer's burden at trial, some proof of an association between the sale of assets with the precise merger would have been helpful. Even more persuasive would have been some evidence, if available, that the reason for the *merger* was Follansbee's lack of confidence in the future of the steel industry and a corresponding confidence in the future of the business of the acquired corporations.[12] Absent proof of a relationship between the sale of the assets and the ultimate merger, it becomes difficult to conclude that the stated business purpose of the sale of assets was also the business purpose of the merger.

Conspicuously absent from the trial record was a statement by any Follansbee official, or corporate minutes, serving to contradict the Commissioner's conclusion that the primary purpose of the merger was tax evasion or avoidance or stating affirmatively the actual purpose for the merger. At best, the purpose had to be divined by the court from an examination of a portion of a proxy statement which, *inter alia,* contained the statement:

> As previously stated, the sale and merger will create a carry-forward tax loss estimated by tax counsel at approximately $4,500,000. This means that the first $4,500.00 of profits earned by the Continuing Corporation through the anticipated successful operation of Consumers' and Frontier will not be subject to Federal Income Tax.[13]

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[12] The proxy statement included an analysis of Frontier's chemical operation and a sketchy description of Consumer's business.

[13] The proxy statement also stated:

> The Continuing Corporation, by virtue of the sale of Follansbee assets, will be in a position to supply substantial amounts of additional needed capital to both Frontier and Consumers.

Accordingly, in exercising our review responsibilities [14] we have carefully examined the entire record to resolve the issue upon which this appeal will turn: Did the taxpayer meet its burden of proving that the Commissioner's determination was in error? We are persuaded that the taxpayer did not meet its burden. It offered no substantial evidence of business purpose and chose to rest its case on the skeletal, tightly worded factual stipulation and on a proxy statement. We do not intimate an absolute necessity for testimony denying that tax avoidance was the primary purpose of the merger, although such testimony, augmented with affirmative statements or proof of appropriate business purpose, would have formidably strengthened this taxpayer's case. At the very minimum, however, for the taxpayer to have prevailed, some substantial evidence should have been introduced by way of explanation of the business purpose for the merger.

AFFIRMED.

[14] We reject the government's invitation to decide this appeal on the clearly erroneous doctrine. *Bay Sound Transp. Co.* v. *United States*, 410 F.2d 505 (5 Cir. 1969). Since there was no oral testimony and no necessity to decide the credibility of witnesses, the fact finder enjoyed no advantages not possessed by us as a court of review.

Relevant Provisions of the General Corporation Law of New Jersey Contained in What Is Designated as "Title 14 Corporations General," the Various Sections of Which Are Designated as "§ 14:1-1," Etc.

14:12-1. CORPORATIONS WHICH MAY MERGE OR CONSOLIDATE.—Any two or more corporations organized under any law or laws of this state, or any corporation organized under the laws of any other state for the purpose of carrying on any kind of business of the same or a similar nature, may merge or consolidate into a single corporation, which may be either one of such merging or consolidating corporations, or a new corporation under the laws of this state to be formed by means of such merger and consolidation; provided, that a merger or consolidation of a corporation of another state, so proposed to be merged or consolidated with such New Jersey corporation, is authorized by the laws of such other state.

The provisions of this chapter relative to merger and consolidation shall not apply to any railroad, turnpike, insurance, canal or banking companies, savings banks, or other corporations intended to derive profit from the loan or use of money.

14:12-2. PROCEDURE; JOINT AGREEMENT.—The directors of the several corporations proposing to merge or consolidate shall enter into a joint agreement under the corporate seals of the respective corporations for their merger or consolidation, prescribing:

a. The terms and conditions of the merger or consolidation and the mode of carrying it into effect;

b. The name of the new corporation, if one shall be so formed or created, or of the consolidated corporation, as the case may be;

c. The number, names and post-office addresses of the first directors and officers of the new or consolidated corporation, who shall hold office until their successors

are chosen or appointed, either according to law or the by-laws of the new corporation, and in case of the creation of a new corporation, how and when the directors and officers shall be chosen or appointed;

d. The number of shares of the capital stock of the new or consolidated corporation, whether common or preferred, and, if any such stock has nominal or par value, the amount or the par value of such shares;

e. The manner of converting the capital stock of each of such merging or consolidating corporations into the stock or obligations of the new or consolidated corporation; and

f. Such other provisions and details as the first mentioned directors shall deem necessary to perfect the merger or consolidation.

14:12-3. AGREEMENT; SUBMISSION TO STOCKHOLDERS; FILING; CERTIFIED COPY TO BE EVIDENCE.—The agreement shall be submitted to the stockholders of each of the merging or consolidating corporations at separate meetings thereof, called for the purpose of considering the same, upon twenty days' notice of the time, place and object thereof, mailed to the last known post-office address of each of such stockholders. At each of such stockholders' meetings a vote of the stockholders shall be taken by ballot, cast in person or by proxy, for the adoption or rejection of such agreement, each share of stock entitling the holder to one vote.

14:12-5. RIGHTS AND POWERS; DUTIES AND LIABILITIES.—When such merger or consolidation is effected, all the rights, privileges, powers and franchises of each of such corporations, both of a public and private nature, all real and personal property, all debts due on any account, as well for stock subscriptions as all other things in action or belonging to each of the corporations, and all and every other interest, shall vest in the consolidated corporation as effec-

tually as they were vested under the laws of this state in any of such corporations by deed or otherwise, shall not revert or be in any way impaired by reason of this chapter.

All rights of creditors and all liens upon the property of the former corporations shall be preserved unimpaired, and the respective former corporations may be deemed to continue in existence in order to preserve the same, and all debts, liabilities, restrictions and duties of the former corporations shall thenceforth attach to such consolidated corporation, and may be enforced against it to the same extent as if they had been incurred or contracted by it.

14:13-4. Corporate Entity Continued for Purpose of Winding Up.—All corporations, whether they expire by their own limitation or be annulled by the legislature or be otherwise dissolved, shall be continued bodies corporate for the purposes of prosecuting and defending suits by or against them, of enabling them to settle and close their affairs, of disposing of and conveying their property and of dividing their capital, but not for the purpose of continuing the business for which they were established.

14:13-1. Dissolution; Procedure.—Every corporation organized under this title may be dissolved in the following manner:

The board of directors shall pass a resolution, declaring it advisable and most for the benefit of the corporation that it be dissolved and calling a meeting of the stockholders to take action thereon. The meeting shall be held upon such notice as the by-laws provide, and in the absence of such provision, upon ten days' notice given personally or by mail. If two-thirds in interest of all the stockholders, whether with or without voting powers and without regard to class, shall at such meeting or any adjournment thereof vote in favor of the dissolution of the corporation and consent thereto in writing, a certificate of such dissolution shall be made by the corporation under its seal and the hands of the president or vice president and the secretary

or assistant secretary. The certificate shall be acknowledged or proved as in the case of deeds of real estate, and, together with such consents in writing and a list of the names and post-office addresses of the directors or officers certified as aforesaid, shall be filed in the office of the secretary of state, who shall thereupon issue a certificate that such certificates and consents have been filed. Upon the issuance of such dissolution certificate by the secretary of state the corporation shall thereupon be dissolved, except as hereinafter provided, and the board of directors shall proceed to settle up and adjust its business and affairs, except that the consent in writing of the stockholders may fix a date subsequent to the date of the issuance of such certificate by the secretary of state as the date on which the dissolution shall take effect, which shall be stated in the certificate issued by the secretary of state. Whenever all the stockholders shall consent in writing to a dissolution, no meeting or notice thereof shall be necessary, but on filing such consents in the office of the secretary of state he shall forthwith issue a dissolution certificate. The board of directors shall in every case cause such certificate of the secretary of state to be published for three weeks successively, at least once in each weekly in a newspaper published in the county in which the principal office of the corporation was last located, and shall, after the completion of such publication, file proof thereof in the office of the secretary of state.

Extracts From "General Corporation Law of the State of Delaware" (Which Now Constitute a Part of Title 8 of the Delaware Code 1953).

Sec. 251 Consolidation or merger of domestic corporations

"(a) Any two or more corporations organized under the provisions of this chapter, or existing under the laws of this State, for the purpose of carrying on any kind of business, may consolidate or merge into a single corporation which may be any one of said constituent corporations or a new

corporation to be formed by means of such consolidation or merger as shall be specified in the agreement required by subsection (b) of this section."

"(b) The directors, or a majority of them, of such corporations as desire to consolidate or merge, may enter into an agreement signed by them and under the corporate seals of the respective corporations, prescribing the terms and conditions of consolidation or merger, the mode of carrying the same into effect, and stating such other facts required or permitted by the provisions of this chapter to be set out in certificates of incorporation, as can be stated in the case of a consolidation or merger, stated in such altered form as the circumstances of the case require, as well as the manner of converting the shares of each of the constituent corporations into shares or other securities of the corporation resulting from or surviving such consolidation or merger, with such other details and provisions as are deemed necessary. Any such agreement may provide for the payment of cash in lieu of the issuance of fractional shares of the resulting or surviving corporation." (Formerly part of Section 59 of the Delaware Corporation Law).

Sec. 252 Consolidation or merger of domestic and foreign corporations; service of process upon surviving corporation

"(a) Any one or more corporations organized under the provisions of this chapter, or existing under the laws of this State, may consolidate or merge with one or more other corporations organized under the laws of any other state or states of the United States, if the laws under which the other corporation or corporations are formed shall permit such consolidation or merger. The constituent corporations may merge into a single corporation, which may be any one of the constituent corporations, or they may consolidate to form a new corporation, which may be a corporation of the State of incorporation of any one of the con-

stituent corporations as shall be specified in the agreement required by subsection (b) of this section."

"(b) All the constituent corporations shall enter into an agreement in writing which shall prescribe the terms and conditions of the consolidation or merger, the mode of carrying the same into effect, the manner of converting the shares of each of the constituent corporations into shares or other securities of the corporation resulting from or surviving such consolidation or merger and such other details and provisions as shall be deemed necessary or proper. There shall also be set forth in the agreement such other facts as shall then be required to be set forth in certificates of incorporation by the laws of the state which are stated in the agreement to be the laws that shall govern the resulting or surviving corporation and that can be stated in the case of a consolidation or merger. Any such agreement may provide for the payment of cash in lieu of the issuance of fractional shares of the resulting or surviving corporation." (Formerly part of Section 59 of the Delaware Corporation Law).

Sec. 259. Status, rights, liabilities, etc., of constituent and surviving corporations following merger or consolidation

"(a) When an agreement of consolidation or merger shall have been signed, acknowledged, filed and recorded, in accordance with the requirements of this subchapter, or upon the effective date of the merger if otherwise stated in the certificate, for all purposes of the laws of this State the separate existence of all the constituent corporations, parties to said agreement, or of all such constituent corporations except the one into which the other or others of such constitutent corporations have been merged, as the case may be, shall cease and the constituent corporations shall become a new corporation, or be merged into one of such corporations, as the case may be, in accordance with the provisions of said agreement, possessing all the rights, privileges, powers and franchises as well of a public as of

a private nature and being subject to all the restrictions, disabilities and duties of each of such corporations so consolidated or merged; and all and singular, the rights, privileges, and all property, real, personal and mixed, including in the case of banks or trust companies, without any order or action on the part of any court or otherwise, appointments, designations, and nominations and all other rights and interests as trustee, executor, administrator, registrar of stocks and bonds, guardian of estates, assignee, receiver, trustee of estates of lunatics and in every other fiduciary capacity, and all debts due to any of said constitutent corporations on whatever account, as well for stock subscriptions as all other things in action or belonging to each of such corporations shall be vested in the corporation resulting from or surviving such consolidation or merger; and all property, rights, privileges, powers and franchises, and all and every other interest shall be thereafter as effectually the property of the resulting or surviving corporation as they were of the several and respective constituent corporations, and the title to any real estate vested by deed or otherwise, under the laws of this State, in any of such constituent corporations, shall not revert or be in any way impaired by reason of this chapter; but all rights of creditors and all liens upon any property of any of said constituent corporations shall be preserved unimpaired, and all debts, liabilities and duties of the respective constituent corporations shall thenceforth attach to said resulting or surviving corporation, and may be enforced against it to the same extent as if said debts, liabilities and duties had been incurred or contracted by it." (Formerly Section 60(a) of the Delaware Corporation Law).

Sec. 261. Effect of consolidation or merger upon pending actions

"Any action or proceeding pending by or against any of the corporations consolidated or merged may be prosecuted as if such consolidation or merger had not taken place, or the corporation resulting from or surviving such consolidation or merger may be substituted in its place."

Extracts From "Agreement of Merger Among Consumers Company, Frontier Chemical Company and Follansbee Steel Corporation, Dated: As of September 13, 1954" (Exhibit B to Proxy Statement).

SECTION 1

"Subject to the conditions in Section 11 and elsewhere herein set forth, as soon as this Agreement of Merger shall have been approved by the votes of holders of the capital stock of Consumers, Frontier, and Follansbee, in accordance with the requirements Title 8 of the Delaware Code of 1953 and such facts shall have been certified by the Secretary or Assistant Secretary of each of said Corporations under their respective corporate seals and this Agreement of Merger so certified shall have been signed, acknowledged, filed and recorded, all as required by the provisions of Section 251 of the Delaware Code of 1953, thereupon said three corporations shall become a single corporation, to-wit: Follansbee, which shall survive the merger. The date upon which Consumers and Frontier shall be so merged into Follansbee is hereinafter referred to as 'the effective date of this Agreement of Merger,' and the single corporation, Follansbee, which shall survive the merger, is sometimes hereinafter called the 'Surviving Corporation.'"

SECTION 2

"Except as hereinafter otherwise specifically set forth, Follansbee, the Surviving Corporation, its identity, existence, purposes, powers, objects, franchises, rights and immunities shall continue unaffected and unimpaired by the merger, and the corporate franchises, entity, existence and rights of Consumers and Frontier shall be merged into Follansbee, and Follansbee shall be fully vested therewith on and after the effective date of this Agreement of Merger. The separate existence of Consumers and Frontier, except as it may be continued by statute, shall cease, and Consumers and Frontier shall be merged into Follansbee in accordance with the provisions of this Agreement of Merger."

Relevant Portions of Illinois Law Effective in 1937 Through 1954.

"157.102. § 102. *Admission of Foreign Corporation.* A foreign corporation organized for profit, before it transacts business in this State, shall procure a certificate of authority so to do from the Secretary of State. A foreign corporation organized for profit, upon complying with the provisions of this Act, may secure from the Secretary of State a certificate of authority to transact business in this State, but no foreign corporation shall be entitled to procure a certificate of authority under this Act to transact in this State the business of banking, insurance, suretyship, or a business of the character of a building and loan corporation. A foreign corporation shall not be denied a certificate of authority by reason of the fact that the laws of the state under which such corporation is organized governing its organization and internal affairs differ from the laws of this State, and nothing in this Act contained shall be construed to authorize this State to regulate the organization or the internal affairs of such corporation.

"157.106. § 106. *Application for certificate of authority.* A foreign corporation, in order to procure a certificate of authority to transact business in this State, shall make application therefor to the Secretary of State, which application shall set forth:

> "(a) The name of the corporation and the state or country under the laws of which it is organized . . .

"157.135. § 135. *License fees payable by foreign corporations.* The Secretary of State shall charge and collect from each foreign corporation authorized to transact business in this State the following license fees, computed on the basis and at the rates prescribed in this Act:

> "(a) An initial license fee at the time of filing its application for a certificate of authority to transact business in this State. . . .

"157.136. § 136. *Basis of computation of license fees payable by foreign corporations.* The basis for the initial license fee payable by a foreign corporation shall be the amount represented in this State, determined in accordance with the provisions of this section, of the sum of its stated capital and paid-in surplus. . . .

"157.137. § 137. *Rate of license fees payable by foreign corporations.* The initial license fee and all additional license fees payable by a foreign corporation shall be computed at the rate of one-twentieth of one per cent of the basis prescribed in this Act for the computation of the initial license fee and additional license fees, respectively.

Relevant Portions of Internal Revenue Code of 1954.

68A Stat. 18

"Sec. 63. Taxable Income Defined.

"(a) *General Rule.*—Except as provided in subsection (b), for purposes of this subtitle the term 'taxable income' means gross income, minus the deductions allowed by this chapter, other than the standard deductions allowed by part IV (sec. 141 and following).

68A Stat. 45

"Sec. 161. Allowance of Deductions.

"In computing taxable income under section 63(a), there shall be allowed as deductions the items specified in this part, subject to the exceptions provided in part IX (sec. 261 and following, relating to items not deductible).

"Sec. 165.

"(a) *General Rule.*—There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

"(b) *Amount of Deduction.*—For purposes of subsection (a), the basis for determining the amount of the deduction

for any loss shall be the adjusted basis provided in section 1011 for determining the loss from the sale or other disposition of property. . . ."

68A Stat. 63

"Sec. 172. Net Operating Loss Deduction.

"(a) *Deduction Allowed.*—There shall be allowed as a deduction for the taxable year an amount equal to the aggregate of (1) the net operating loss carryovers to such year, plus (2) the net operating loss carrybacks to such year. For purposes of this subtitle, the term 'net operating loss deduction' means the deduction allowed by this subsection.

. . .

"(c) *Net Operating Loss Defined.*—For purposes of this section, the term 'net operating loss' means (for any taxable year ending after December 31, 1953) the excess of the deductions allowed by this chapter over the gross income. Such excess shall be computed with the modifications specified in subsection (d).

"(d) *Modifications.*—The modifications referred to in this section are as follows:

. . .

"(4) *Nonbusiness deductions of taxpayers other than corporations.*—In the case of a taxpayer other than a corporation, the deductions allowable by this chapter which are not attributable to a taxpayer's trade or business shall be allowed only to the extent of the amount of the gross income not derived from such trade or business. For purposes of the preceding sentence—

"(A) Any gain or loss from the sale or other disposition of—

"(i) property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 167, or

"(ii) real property used in the trade or business, shall be treated as attributable to the trade or business; . . .

68A Stat. 80

"Sec. 269. Acquisitions made to Evade or Avoid Income Tax.

"(a) *In General.*—If—

"(1) any person or persons acquire, or acquired on or after October 8, 1940, directly or indirectly, control of a corporation, or

"(2) any corporation acquires, or acquired on or after October 8, 1940, directly or indirectly, property of another corporation, not controlled, directly or indirectly, immediately before such acquisition, by such acquiring corporation or its stockholders, the basis of which property, in the hands of the acquiring corporation, is determined by reference to the basis in the hands of the transferor corporation.

and the principal purpose for which such acquisition was made is evasion or avoidance of Federal income tax by securing the benefit of a deduction, credit, or other allowance which such person or corporation would not otherwise enjoy, then the Secretary or his delegate may disallow such deduction, credit, or other allowance. For purposes of paragraphs (1) and (2), control means the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote or at least 50 percent of the total value of shares of all classes of stock of the corporation.

. . .

"(c) *Presumption in Case of Disproportionate Purchase Price.*—The fact that the consideration paid upon an acquisition by any person or corporation described in subsection (a) is substantially disproportionate to the aggregate—

"(1) of the adjusted basis of the property of the corporation (to the extent attributable to the interest

acquired specified in paragraph (1) of subsection (a), or of the property acquired specified in paragraph (2) of subsection (a); and

"(2) of the tax benefits (to the extent not reflected in the adjusted basis of the property) not available to such person or corporation otherwise than as a result of such acquisition.

shall be prima facie evidence of the principal purpose of evasion or avoidance of the Federal income tax. This subsection shall apply only with respect to acquisitions after March 1, 1954.

68A Stat. 124

"Sec. 381. (a) GENERAL RULE.—In the case of the acquisition of assets of a corporation by another corporation—

"(1) in a distribution to such other corporation to which section 332 (relating to liquidations of subsidiaries) applies, except in a case in which the basis of the assets distributed is determined under section 334 (b)(2); or

"(2) in a transfer to which section 361 (relating to nonrecognition of gain or loss to corporations) applies, but only if the transfer is in connection with a reorganization described in subparagraph (A), (C), (D) (but only if the requirements of subparagraphs (A) and (B) of section 354(b)(1) are met), or (F) of section 368 (a)(1),

"the acquiring corporation shall succeed to and take into account, as of the close of the day of distribution or transfer, the items described in subsection (c) of the distributor or transferor corporation, subject to the conditions and limitations specified in subsections (b) and (c).

. . .

"(c) Items of the Distributor or Transferor Corporation.—The items referred to in subsection (a) are:

"(1) Net Operating Loss Carryovers.—The net operating loss carryovers determined under section 172, subject to the following conditions and limitations:

"(A) The taxable year of the acquiring corporation to which the net operating loss carryovers of the distributor or transferor corporation are first carried shall be the first taxable year ending after the date of distribution or transfer. . . .

68A Stat. 129

"Sec. 382. (a) Purchase of a Corporation and Change in its Trade or Business.—

"(1) In General.—If at the end of a taxable year of a corporation—

"(A) Any one or more of those persons described in paragraph (2) own a percentage of the total fair market value of the outstanding stock of such corporation which is at least 50 percentage points more than such person or persons owned at—

"(i) the beginning of such taxable year, or

"(ii) the beginning of the prior taxable year,

"(B) the increase in percentage points at the end of such taxable year is attributable to—

"(i) a purchase by such person or persons of such stock, the stock of another corporation owning stock in such corporation, or an interest in a partnership or trust owning stock in such corporation, or

"(ii) a decrease in the amount of such stock outstanding or the amount of stock outstanding of another corporation owning stock in such corpora-

tion, except a decrease resulting from a redemption to pay death taxes to which section 303 applies, and

"(C) such corporation has not continued to carry on a trade or business substantially the same as that conducted before any change in the percentage ownership of the fair market value of such stock,

"the net operating loss carryovers, if any, from prior taxable years of such corporation to such taxable year and subsequent taxable years shall not be included in the net operating loss deduction for such taxable year and subsequent taxable years.

"(2) Description Person or Persons.—The person or persons referred to in paragraph (1) shall be the 10 persons (or such lesser number as there are persons owning the outstanding stock at the end of such taxable year) who own the greatest percentage of the fair market value of such stock at the end of such taxable year; except that, if any other person owns the same percentage of such stock at such time as is owned by one of the 10 persons, such person shall also be included. If any of the persons are so related that such stock owned by one is attributed to the other under the rules specified in paragraph (3), such persons shall be considered as only one person solely for the purpose of selecting the 10 persons (more or less) who own the greatest percentage of the fair market value of such outstanding stock.

"(3) Attribution of Ownership.—Section 318 (relating to constructive ownership of stock) shall apply in determining the ownership of stock, except that sections 318(a)(2)(C) and 318(a)(3)(C) shall be applied without regard to the 50 percent limitation contained therein.

"(4) Definition of Purchase.—For the purposes of this subsection the term 'purchase' means the acquisi-

tion of stock, the basis of which is determined solely by reference to its cost to the holder thereof, in a transaction from a person or persons other than the person or persons the ownership of whose stock would be attributed to the holder by application of paragraph (3).

"(b) Change of Ownership as the result of a Reorganization.—

"(1) In General.—If, in the case of a reorganization specified in paragraph (2) of section 381(a), the transferor corporation or the acquiring corporation—

"(A) has a net operating loss which is a net operating loss carryover to the first taxable year of the acquiring corporation ending after the date of transfer, and

"(B) the stockholders (immediately before the reorganization) of such corporation (hereinafter in this subsection referred to as the 'loss corporation'), as the result of owning stock of the loss corporation, own (immediately after the reorganization) less than 20 percent of the fair market value of the outstanding stock of the acquiring corporation,

the total net operating loss carryover from prior taxable years of the loss corporation to the first taxable year of the acquiring corporation ending after the date of transfer shall be reduced by the percentage determined under paragraph (2).

"(2) Reduction of Net Operating Loss Carryover.—The reduction applicable under paragraph (1) shall be the percentage determined by subtracting from 100 percent—

"(A) the percent of the fair market value of the outstanding stock of the acquiring corporation owned (immediately after the reorganization) by

the stockholders (immediately before the reorganization) of the loss corporation, as the result of owning stock of the loss corporation, multiplied by

"(B) five.

"(3) Exception to Limitation in this Subsection.—The limitation in this subsection shall not apply if the transferor corporation and the acquiring corporation are owned substantially by the same persons in the same proportion. . . .

"(6) Stock of Corporation Controlling Acquiring Corporation.—If the stockholders of the loss corporation (immediately before the reorganization) own, as a result of the reorganization, stock in a corporation controlling the acquiring corporation, such stock of the controlling corporation shall, for purposes of this subsection, be treated as stock of the acquiring corporation in an amount valued at an equivalent fair market value.

"(c) Definition of Stock.—For purposes of this section, 'stock' means all shares except nonvoting stock which is limited and preferred as to dividends."

Technical Information Release No. 773. By Commission October 13, 1965.

The United States Internal Service today announced that it will not follow the decision of the United States Court of Appeals for the Ninth Circuit in the case of *Maxwell Hardware Co.* v. *Commissioner,* 343 F.2d 713 (1965).

In that case, the circuit court held that the Supreme Court's decision in *Libson Shops, Inc.* v. *Koehler,* 353 U.S. 382 (1957), has no precedential value under the 1954 Code, and that the net operating loss carryovers involved therein were not subject to disallowance under section 172, 269 or 382. The court, by way of dictum, stated that the Com-

misioner might have successfully applied section 482 in this case.

It is the position of the Revenue Service that in cases similar to *Maxwell Hardware,* sections 269 and 382, as well as section 482, are applicable in dealing with the carryover of losses. The Revenue Service believes that the foregoing statutory provisions must be construed to effectuate congressional intent in combating "trafficking in loss carryovers." Moreover, the Service also believes that the loss carryover in cases similar to *Maxwell Hardware* should be denied under the rationale of the *Libson Shops* decision since to permit a loss carryover in such cases would run counter to the legislative objectives of the carryover privilege.

The cornerstone of the *Libson Shops* decision was a searching examination of the purposes of the carryover privilege. Thus, in approaching the question of whether the taxpayer was entitled to a loss carryover, the Supreme Court held that the loss carryover provision was not automatic and that the "availability of . . . [the loss carryover] privilege depends on the proper interpretation to be given to the carryover provisions." The Service believes that this fundamental type of statutory analysis was not made obsolete by the enactment in 1954 of provisions limiting or denying loss carryovers in certain situations involving abuses that were specifically brought to the attention of Congress. It is the view of the Service that the basic approach of the Supreme Court in *Libson Shops* retains vitality under the 1954 Code in interpreting the application of section 172.

Accordingly, the Service will apply *Libson Shops* in any loss carryover case under the 1954 Code, not contemplated by the announcement in Revenue Ruling 58-603, C.B. 1958-2, 147, where there has been both a 50 percent or more shift in the benefits of a loss carryover (whether direct or indirect and including transactions having the

effect of shifting the benefit of the loss by shifting assets, stock, profit interests or other valuable rights) and a change in business as defined in section 382(a) and the regulations thereunder. The Service will not rely on *Libson Shops* under the 1954 Code in any loss carryover case where there has been less than a 50 percent change in the beneficial ownership of the loss or where there has been no change in business as defined in section 382(a) and the regulations thereunder. However, the Service will continue to rely on sections 269 and 482, where appropriate, in dealing with the carryover of losses. Revenue Ruling 63-40, C.B. 1963-1, 46 will be modified to the extent inconsistent herewith.

The Revenue Service stated that certiorari was not requested in *Maxwell Hardware* due to the absence of a direct conflict between the circuits. The decision will not be followed as a precedent in the disposition of similar cases.

(Copied from 1965 Commerce Clearing House Income Tax Service, ¶ 6751)

Item 1—Extract from House and Senate Committee Reports on § 172 of the 1954 Code:

> "A further substantive change will permit taxpayers other than corporations who sell a business or certain business assets in effect to include any loss sustained on the sale of such business or business assets as part of a net operating loss for the year of the sale (Corporations are entitled to this treatment under present law and under this section). Thus, subsection (d)(4)(A) will overrule the decision in Joseph Sic. v. Commissioner (10 T.C. 1096, 177 F.2d 649 (CA-8), certiorari denied, 339 U.S. 913, 70 S.Ct. 572), and similar cases, which held, for example, that a farmer who sold his farm at a loss could not include such loss as part of his net operating loss. The cases indicated

that such loss was a nonbusiness loss since the taxpayer was not in the business of selling farms. The new provisions will reach the opposite result." (U.S. Cong. & Admin. News 1954, pp. 4193, 48-49)

Item 2—Extract from House Committee Report on § 381 of the 1954 Code:

"*D. Carryover to successor corporations (sec. 381)* Present law makes no provision for the transfer from one corporation to another in a tax-free merger or consolidation, of the major tax benefits, privileges, elective rights and obligations which were available to the predecessor. These include such items as loss carryover, unamortized bond discount, installment sales reporting, LIFO inventory method, etc. The courts have held, in general, that such tax attributes of a corporation may be preserved *only by continuing the corporation's identity.* For example, *the surviving corporation in a merger is generally entitled only to the tax attributed from its own premerger experience and not from the experience of the other corporations merged.* More recently, however, this separate entity rule appears not to have been followed.

"As a result, present practice rests on courtmade law which is uncertain and frequently contradictory. *Moreover, whether or not the carryover is allowed should be based upon economic realities rather than upon such artificialities as the legal form of the reorganization.*

. . . . . .

"The new rules enable the successor corporation *to step into* the *'tax shoes' of its predecessor* corporation without necessarily conforming to artificial legal requirements which now exist under court-made law. . . ." (U.S. Cong. & Admin. News 1954, pp. 4066-7, emphasis supplied)

Item 3(a) Extract from Senate Committee Report on § 122 of the Revenue Act of 1943 Respecting § 120 of the 1939 Code:

"The objective of the section, as stated in the report on the House bill, is to prevent the distortion through tax avoidance of the deduction, credit, or allowance provisions of the Code, particularly those of the type represented by the recently developed practice of corporations with large excess profits (or the interests controlling such corporations) acquiring corporations with current, past, or prospective losses or deductions, deficits, or current or unused excess profits credits, for the purpose of reducing income and excess profits taxes. (1944 Cum. Bul. 1016)

. . . . . .

"Your committee recognizes these facts and is in agreement with these objectives. Your committee also recognizes the difficulty of formulating a proper general provision which will be helpful in administration and decision in distinguishing between business conduct which effectuates the basic purposes of the deduction, credit, and allowance provisions of the Code and arrangements which distort, pervert, and defeat such basic purposes. (1944 Cum. Bul. 1016)

. . . . . .

". . . To determine what transactions constitute the condemned evasion or avoidance, section 129 must be read in its context and background. It is superimposed on the several existing provisions of the income and excess profits tax law, the basic policies of which contemplate the bona fide conduct of business in the ordinary way. Basic to the deduction, credit, and allowance provisions is a continuing enterprise so conducting its affairs. A substantial number of the Code provisions, like sections 112, 113, and 141, are especially designed to remove tax impediments from such business transactions. It is nonconfirmity to the basic policies of these provisions of the Code which is

denoted by tax avoidance in section 129, and it is in the light of these basic policies that section 129 would necessarily have to be applied and administered. Such is also the case under section 45 and under the principles applied in the absence of the explicit statutory language. The National securities and Spreckles cases cited above aptly illustrate such nonconformity, violating in those cases the basic policies of the deduction provisions, and in the Spreckles case, the consolidated returns provisions. The test of this nonconformity is, as was indicated in *Higgins* v. *Smith*, whether the transaction or a particular factor thereof 'distorts the liability of the particular taxpayer' when the 'essential nature' of the transaction or factor is examined in the light of the 'legislative plan' which the deduction or credit is intended to effectuate. (1944 Cum. Bul. 1017)

Item 3(b) Extract from Conference Report on the Revenue Act of 1943 Respecting § 129 of the 1939 Code:

"Under the conference agreement, the categories of tax evasion and tax avoidance selected for specific treatment under section 129 are those characterized either by the acquisition of control of a corporation, or by the acquisition of property (with a transferred basis) by one corporation from another not controlled immediately prior to such acquisition by such first corporation. . . ." (1944 CB 1069.)

Item 4 Extract from House and Senate Committee Reports on the 1954 Code Respecting § 269(c):

". . . This provision will apply to cases where the *tax basis* of the property *acquired* for depreciation and other purposes, together with the tax value of other tax benefits, such as operating loss carryovers, is *substantially greater* than the *amount paid* for the property. Disparities of this type generally arise where the *old basis* is continued in the hands of the new owner." (U.S. Cong. & Admin. News 1954, pp. 4057, 4670, emphasis supplied)

Certain Specific Organization Expenses of Consumers

In the following part of the stipulation in both Nos. 30,116 and 30,117, Consumers Company is called "Delaware" and its predecessor, an Illinois corporation, is called "Illinois." It was stipulated that during the period from June 19, 1934, until February 28, 1938, "Illinois and Delaware incurred and paid the following organization and reorganization expenses to the persons or firms listed in respect of the services described: . . .

"(m) Halsey, Stuart & Co., Inc. $14,592.90

"The Court ordered Delaware to pay Halsey, Stuart & Co., Inc. reasonable compensation for services rendered and to be rendered as Exchange Agent in making the payments of cash and effecting the exchange of securities of Delaware as requird by the Substitute Plan of Reorganization and the Court decree confirming said Plan.

"(n) Continental Illinois National Bank $10,029.45

"Continental Illinois National Bank and Trust Company of Chicago acted as the transfer agent of Delaware and of the trustees of the stock trust created under the Substitute Plan of Reorganization.

"(o) Chicago Stock Exchange $3,000.00

"The amount listed was paid to the Chicago Stock Exchange (predecessor to the Midwest Stock Exchange) by Delaware during 1937 to cover listing fees for various securities issued by the Company.

"(p) Secretary of State of Illinois $3,209.34

"The amount listed was paid to the Secretary of State of Illinois for for various services including fees for minis-

terial and recording services required under applicable state laws of Illinois.

"(q) Security Banknote Company $3,564.25

"(r) Security Banknote Company $3,564.25

"This amount was paid to Security Bank Note Company by Illinois and Delaware for the printing of new certificates evidencing ownership of securities issued by the reorganized company."

Evidence Respecting Erroneous Findings of Fact by the Court of Appeals

In the discussion of the statutory provison that the "principle purpose" shall be "the evasion or avoidance of Federal income tax," the Court of Appeals concluded, in effect, that there was no proof of association between the sale of assets and the precise merger, and made other comments about the absence of evidence which might have been persuasive to show that tax avoidance was not the principle purpose of the merger, pp. 16a-20a. There is a specific statement that Follansbee had converted its assets to cash at some point before the stockholders' meeting, p. 18a.

That statement, and the foregoing implications of other statements in the opinion, are plainly erroneous. This is shown by the notice of the call of the special meeting of the stockholders of Follansbee to be held on October 27, 1954, given by order of the Board of Directors dated October 4, 1954, and in the Proxy Statement attached thereto. The items of business to be transacted were described in the notice as follows:

"1. 'The adoption or rejection of' a Purchase Contract dated August 2, 1954, and amended September 22, 1954, of

which a copy was attached as Exhibit A to the Proxy Statement.

"2. 'The adoption or rejection *(subject to the adoption of the Purchase Contract)* of a certain Agreement of Merger dated September 15, 1954,' a copy of which was attached as Exhibit B to the Proxy Statement. This agreement provided for the merger of Consumers and Frontier into Follansbee described on page 4 and for the change of Follansbee's name to Union Chemical. Parts of this agreement are copied on p. 28a.

"3. Any other business that might properly come before the meeting." (Emphasis supplied)

It was stipulated that the contents of the Proxy Statement and other material should constitute evidence in No. 30,117 without further proof. The Proxy Statement contains specific assertions that the merger was conditioned, and dependent, upon consummation of the sale of the Follansbee assets, pursuant to the Purchase Contract. No specific relief is sought in this Court in reliance on these additional facts. They are stated, primarily, to show that the Court of Appeals proceeded upon an erroneous view of the facts as to the relationship between the Purchase Contract and the merger, and that the decision is not necessarily based on a question of fact.